

Message Text

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ACTION EA-14

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TRSE-00 SS-15 STR-08 OMB-01 CEA-02 CIAE-00 COME-00

FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12 LAB-06 SIL-01

L-03 H-02 DODE-00 PA-03 USIA-12 PRS-01 AGR-20 RSR-01

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C O N F I D E N T I A L TOKYO 8241

PASS TREASURY AND FEDERAL RESERVE

E. O. 11652: GDS

TAGS: EFIN, JA

SUBJ: JAPAN'S CAPITAL EXPORTS AND RESERVE MANAGEMENT POLICIES

SUMMARY: POLICY OF " HIDING RESERVES" PERHAPS BETTER VIEWED AS MERELY ONE ELEMENT OF GENERAL GOJ POLICY OF SEEKING TO FINANCE SURPLUS ON CURRENT ACCOUNT BY GENERATING SUFFICIENT OUTFLOWS OF LONG- TERM CAPITAL TO PREVENT FUTURE RESERVE BUILDUP. FOLLOWING ARE FINATT VIEWS ON THIS SUBJECT.

1. OFFICIAL RESERVE BUILDUP IN 1971-72 (\$13.7 BIL) CAN BE ATTRIBUTED PRIMARILY TO ENORMOUS CURRENT ACCOUNT SURPLUS (\$12.5 BIL). DESPITE FIGHTER FOREX CONTROLS, INFLOWS OF FOREIGN CAPITAL EXTREMELY LARGE (\$1 BIL ERROS AND OMISSIONS WITH PERHAPS LEADS AND LAGS AND \$7.4 BIL IN ALL OTHER FORMS). THUS, GOJ DESPERATELY SOUGHT WAYS OF ACHIEVING CAPITAL EXPORTS AND RESORTED TO VARIETY OF TECHNIQUES.

2. PROBLEM ON PRIVATE CAPITAL EXPORTS WAS EXCHANGE RISK.

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WHEREAS JAPANESE PERFECTLY WILLING TO PURCHASE DOLLAR-DENOMINATED FOREIGN ASSETS PRIOR MID-1971, FOREX LOSSES DRIED UP TRADITIONAL FLOWS. HENCE GOJ INITIALLY RESORTED TO DIRECT PURCHASES OF FOREIGN ASSETS BY MOF AND BOJ AND DESPERATELY SOUGHT WAYS OF CREATING PRIVATE FLOWS. SUCCESS OF FOREIGN CURRENCY LOAN SYSTEM (FCLS) (REPORTED IN TOKYO 9026, AUG 24, 1972) ALONG WITH SUBSIDENCE OF SPECULATION, AND REDUCED CURRENT ACCOUNT SURPLUS IN RECENT MONTHS, HAVE REDUCED NEED FOR DIRECT OFFICIAL PURCHASES OF FOREIGN ASSETS AS PRIVATE SECTOR FLOWS NOW SUFFICIENT.

3. FCLS ENABLES PRIVATE SECTOR AVOID EXCHANGE RISK BY HAVING IT BORNE BY OFFICIAL AGENCIES PROVIDING CREDIT. MOREOVER, LOW INTEREST RATE MAKES THESE FUNDS ATTRACTIVE. THUS JAPANESE WHO WOULD REQUIRE FUNDS FOR PAYMENTS ABROAD CAN OBTAIN THEM DOMESTICALLY UNDER COMPETITIVE CONDITIONS. THESE FUNDS BEING USED FOR (A) DIRECT INVESTMENT IN RESOURCE EXPLORATION AND DEVELOPMENT AS WELL AS OTHER TYPES OF INVESTMENT, (B) DEVELOPMENT OF FUTURE RAW MATERIAL SUPPLIES BY JAPANESE JOINT VENTURES AND (C) FINANCING OF FUTURE IMPORTS SUCH AS URANIUM AND AIRCRAFT. SINCE GOVT AGENCIES MAKE THESE LOANS, VOLUME CAN BE DIRECTLY CONTROLLED THROUGH APPROVAL OR NONAPPROVAL OF BORROWING REQUESTS.

4. PRIVATE EXPORTS OF YEN-DENOMINATED CAPITAL MORE DIFFICULT TO GENERATE. TIGHTER MONETARY POLICY IS DRYING UP POSSIBILITY OF PRIVATE BANK LOANS TO FOREIGNERS. ON OTHER HAND, POSSIBILITIES EXIST FOR GRANTING LONG- TERM CREDIT FOR EXPORTS FOR JAPANESE CAPITAL GOODS. SHIPBUILDING INDUSTRY ALREADY DENOMINATING VIRTUALLY ALL CONTRACTS IN YEN AND YEN LOANS EVIDENTLY ACCEPTABLE TO FOREIGN BORROWERS. OUTFLOW OF YEN-DENOMINATED PORTFOLIO CAPITAL WILL BE MORE DIFFICULT TO GENERATE THAN IN THE CASE OF GERMANY BECAUSE (A) OF HIGH INTEREST RATES AND (B) BORROWERS UNABLE TO COVER EXCHANGE RISK BECAUSE OF JAPANESE FOREIGN EXCHANGE CONTROLS.

5. THOSE CONTROLS CURRENTLY PREVENTING INFLOW OF MANY TYPES OF FOREIGN FUNDS. GOJ WELL AWARE OF INTEREST ABROAD FOR BUILDUP OF YEN DEPOSITS. THIS COULD LEAD TO YEN AS
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TRANSACTION AND RESERVE CURRENCY. AT PRESENT GOJ UNWILLING TO ACCEPT POSSIBLE BURDENS OF YEN IN SUCH A ROLE. NEVERTHELESS A FEW (OIL- PRODUCING) COUNTRIES ARE BEING ALLOWED TO BUILD UP YEN HOLDINGS IN JAPANESE BANKS. BANKS ARE MEETING FOREX REGULATIONS BY EQUIVALENT INCREASE IN HOLDINGS OF FOREIGN ASSETS. HOWEVER, IN ORDER FOR BANKS TO AVOID EXCHANGE RISK, THEY MUST DENOMINATE FOREIGN

ASSETS IN YEN. PRESUMABLY SUCH ASSETS INCLUDE LOANS TO JAPANESE JOINT VENTURES ABROAD AND EXPORT CREDITS.

6. NO FIGURES AVAILABLE ON CURRENCY DENOMINATION OF JAPANESE CAPITAL FLOWS. FINATT BELIEVES PRESENT GOJ MEASURES, ALONG WITH MARKET FACTORS, PRESENTING SUFFICIENT OUTFLOW OF FUNDS TO FINANCE DIMINISHED CURRENT ACCOUNT SURPLUS AND NORMAL INFLOWS OF CAPITAL PERMITTED UNDER EXCHANGE CONTROLS. AS CONSEQUENCE GOJ UNDER MUCH LESS PRESSURE TO "HIDE RESERVES" AND IN FACT HAS TAKEN SOME INVESTMENTS IN USG AGENCY PAPER BACK INTO RESERVES. THEREFORE GOJ FINANCE OFFICIALS GENERALLY RELAXED ABOUT LEVEL OF OFFICIALLY REPORTED RESERVES. NEVERTHELESS, TECHNIQUES ARE STILL BEING SOUGHT TO GENERATE SUBSTANTIALLY LARGER OUTFLOW OF YEN-DENOMINATED LONG-TERM FUNDS SO THAT GOVT AGENCIES CAN WITHDRAW FROM UNDERWRITING FOREX RISKS NOW ENTAILED IN FCLS. HOWEVER, FOR PRIVATE SECTOR TO UNDERTAKE FOREX RISK, BETTER BALANCED FOREIGN EXCHANGE MARKET NECESSARY AND/OR SUBSTANTIAL YEN DEPOSIT HOLDINGS BY PRIVATE RESIDENTS. THIS WOULD REINFORCE USE OF YEN AS TRANSACTIONS CURRENCY AND IMPROVE BREADTH OF FORWARD EXCHANGE MARKET. THAT ROAD COULD, HOWEVER, LEAD TO STATUS OF YEN AS RESERVE CURRENCY WITH ALL OF ITS POTENTIAL BURDENS. INGERSOLL

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